INDEX

CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 169

THE UNITED STATES, PETITIONER

v.

FREDERICK PLEASANTS

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 14–29) is reported in 22 F. Supp. 964.

JURISDICTION

The judgment of the Court of Claims was entered April 4, 1938 (R. 29). The petition for writ of certiorari was filed July 1, 1938 (R. 29), and was granted October 10, 1938. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Court of Claims erred in holding that in computing a taxpayer's net income under Section 23 (n), Revenue Act of 1932, on the basis of which 15 percent is allowable for charitable deductions, a capital net loss should be disregarded.

STATUTE INVOLVED

The relevant portions of the Revenue Act of 1932 will be found in the Appendix, *infra*, pp. 26–30.

STATEMENT

This is a suit brought in the Court of Claims for the recovery of income tax paid for the year 1932 which the Court of Claims held the respondent was entitled to recover.

The special findings of fact of the Court of Claims may be summarized as follows:

Respondent duly filed his individual income tax return for the year 1932 on March 15, 1933, showing a total tax of $161.77, which was paid on the same date. On this return respondent reported a total income of $99,123.31, consisting of salaries, interest, and dividends, and total deductions of $5,235.15, consisting of taxes paid, losses by fire, storm, etc., and contributions to charitable organizations. He also reported a capital net loss of $157,642.62 (R. 12).

As a result of an audit of respondent's books and records the Commissioner of Internal Revenue determined that there was an additional tax due from the respondent in the amount of $908.92, and so notified respondent on April 13, 1934. The deficiency in tax of $908.92, together with interest of $60.87, aggregating $969.79, was thereafter assessed and, upon demand, the same was paid on May 12, 1934 (R. 12–13).

In arriving at the deficiency in tax the following adjustments were made: (1) Gross income was re-

duced to $96,702.67 from $99,123.31. (2) The total deductions claimed on the return were reduced to $1,739.15 from $5,235.15. This reduction was caused by the disallowance of the charitable deductions on the ground that since the ordinary net income reduced by the capital net loss resulted in a net loss for the year, there was no income against which to apply the 15% deduction for charitable contributions under Section 23 (n) of the Revenue Act of 1932. (3) Capital net loss was reduced to $154,921.98 from $157,642.62 (R. 13).

On May 19, 1934, respondent duly filed a claim for refund for $969.79 for 1932 upon the ground that the amount of $3,496 representing charitable contributions was less than 15 percent of his taxable net income and was a proper and legal deduction. The claim was rejected on January 17, 1935 (R. 13). This suit was filed in the Court of Claims March 6, 1936 (R. 1).

On April 4, 1938, the Court of Claims rendered an opinion in favor of respondent (R. 14–29), and entered judgment in the amount of $969.79, together with interest from May 12, 1934 (R. 29).

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that capital net losses are not deductible from gross income in arriving at the "net income" under Section 23 (n), Revenue Act of 1932.

2. In holding that the "net income" to be used as the base for the computation of the 15 percent de-

duction for charitable contributions is to be computed without taking into account a capital net loss sustained by the taxpayer, where the tax as computed under the provisions of Section 101, Revenue Act of 1932, is larger than the tax computed without regard to the provisions of that section.

3. In failing to hold that since the respondent's capital net loss exceeded his ordinary net income as computed without any adjustment for such capital net loss, there was no "net income" within the meaning of Section 23 (n), Revenue Act of 1932.

4. In failing to enter judgment for the United States and dismiss the petition.

SUMMARY OF ARGUMENT

I

Account must be taken of a capital net loss in computing the taxpayer's "net income" which forms the basis for the 15 per cent limitation on charitable deductions under Section 23 (n) of the Revenue Act of 1932. Net income is defined in the Act as gross income minus deductions allowed under Section 23. Gross income clearly includes capital gains, and the deductions allowed clearly include capital losses. The separate treatment of capital gains and losses in Section 101 does not affect the definition of "net income," but merely segregates ordinary net income from capital gains and capital losses for purposes of applying a different rate of tax.

The case is indistinguishable in principle from *Helvering* v. *Bliss*, 293 U. S. 144. In that case it

was held that a capital net gain must be taken into account in computing net income under Section 23 (n). Otherwise, it was pointed out, "ordinary net income" would be substituted for "net income." Four circuit courts of appeals and the Board of Tax Appeals have indicated that no distinction is to be drawn in the treatment of capital net gains and of capital net losses in this regard. The decision of the court below stands alone.

II

There are no considerations of policy which would justify a disregard of the terms of the Act. Although Congress has indicated a purpose to encourage charitable contributions, deductions therefor can be taken only where plainly permitted by the Act. Furthermore, there is a definite legislative policy to discourage the taking of capital losses for the purpose of offsetting ordinary net income. This purpose results in the requirement that a tax be paid even though the taxpayer has no actual income in the economic sense during the taxable year. This result, which is not questioned, constitutes a more fundamental hardship than any which may be pointed to in relation to the Commissioner's treatment of capital net losses for purposes of the limitation of charitable deductions.

III

The position of the Government is supported by administrative practice of long standing. The rule here contended for was announced in 1924 and has

been adhered to consistently thereafter, save for a period from 1932 to 1934 during which the problem was thrown into confusion by decisions of the Board of Tax Appeals. This confusion was resolved by the decision in the *Bliss* case, *supra*, and the Commissioner thereupon resumed the earlier consistent practice, to which the Government's position herein conforms.

ARGUMENT

I

IN COMPUTING NET INCOME ACCOUNT MUST BE TAKEN OF A CAPITAL NET LOSS, UNDER THE PLAIN TERMS OF THE ACT AND THE RATIONALE OF THE DECISION IN HELVERING V. BLISS, 293 U. S. 144

Respondent in 1932 made charitable contributions in the amount of $3,496. He had an "ordinary" net income, that is, gross income exclusive of capital gains minus allowable deductions exclusive of capital losses, in the amount of $94,963.52. He had capital losses in excess of capital gains—a capital net loss—in the amount of $154,921.98. Charitable contributions may be deducted from gross income under Section 23 (n) of the Revenue Act of 1932 only to the extent of 15 per cent of the taxpayer's "net income" computed without regard to charitable contributions. The case at bar turns on the meaning of the term "net income" as thus employed.

Respondent takes the position that his net income was $94,963.52 and that as his charitable contributions were less than 15 per cent of this amount, they

were deductible in full. The Commissioner's position is that that amount was "ordinary" net income as defined in Section 101 (c) (7) for purposes of computation of a tax at a separate rate; that in determining respondent's "net income" within Section 23 account must be taken of his capital net loss; that respondent had no net income; and that therefore no deduction for charitable contributions is permissible.

The Commissioner's position is that in determining "net income" as used in Section 23 (n), capital gains must be included in gross income and capital losses in deductions from gross income, and that this is true whether there is a capital net gain or a capital net loss. That this inclusion of capital gains and capital losses is the proper method in the case of a capital net gain is settled by *Helvering* v. *Bliss*, 293 U. S. 144. That decision held that the definition of net income in Section 21 is not affected by the fact that capital gains and capital losses are segregated by Section 101 for purposes of the application of a separate rate of tax to capital net gains. Respondent contends, however, that in the case of a capital net loss, where there is a similar segregation under Section 101 for purposes of a separate rate of deduction on capital net losses, capital gains and capital losses must be disregarded in computing "net income" under Section 21 and Section 23 (n).

In our view, the *Bliss* case does not permit of any distinction between the case of a capital net gain and the case of a capital net loss, with respect to the

meaning of "net income." Every court which has considered the question, except the court below, has shared our view. The question was squarely decided in *Avery* v. *Commissioner*, 84 F. (2d) 905 (C. C. A. 7th), certiorari denied, 299 U. S. 604, rehearing denied, 300 U. S. 686, and in *Lockhart* v. *Commissioner*, 89 F. (2d) 143 (C. C. A. 3rd), certiorari denied, 302 U. S. 711, and *Heinz* v. *Commissioner*, 94 F. (2d) 832 (C. C. A. 3rd). The Board of Tax Appeals has reached the same conclusion. *Nippert* v. *Commissioner*, 32 B. T. A. 892; *Hill* v. *Commissioner*, 33 B. T. A. 891, affirmed without consideration of the point, 88 F. (2d) 941 (C. C. A. 8th); *Zimmerman* v. *Commissioner*, 36 B. T. A. 618, pending in the Circuit Court of Appeals for the Third Circuit.[1] The same view has been expressed, though without specific decision of the point, in *Bliss* v. *Commissioner*, 68 F. (2d) 890, 892 (C. C. A. 2nd), affirmed 293 U. S. 144, *supra*, and *White* v. *Atkins*, 69 F. (2d) 960, 963 (C. C. A. 1st).

Before discussing the *Bliss* case, however, the provisions of the statute should be examined in greater detail. Section 23 (n) provides that the 15 per cent limitation on charitable deductions shall be measured by "net income." Net income is defined in section 21 to mean "gross income computed under Section 22, less the deductions allowed by section 23."

[1] To the same effect see *Lockhart* v. *Commissioner*, 32 B. T. A. 732, affirmed, 89 F. (2d) 143, *supra; Avery* v. *Commissioner*, 32 B. T. A. 948, affirmed, 84 F. (2d) 905, *supra; Heinz* v. *Commissioner*, 34 B. T. A. 885, affirmed, 94 F (2d) 832, *supra*.

Gross income computed under Section 22 clearly includes capital gains; it has been the scheme "of all the Revenue Acts since that of 1916 * * * to sweep all income of every sort, including capital gains, into what is denominated gross income * * *" (*Helvering* v. *Bliss*, 293 U. S. at 147). And the deductions allowed by Section 23 in the computation of net income clearly include capital losses, provided only that, as required by paragraph (e) of Section 23, they were incurred in trade or business or in transactions entered into for profit.[2] In the case at bar, therefore, in determining net income it is necessary to take into account the respondent's capital loss, which exceeded his gross income and so left no net income as a basis for deducting charitable contributions.

The result is not affected by the provisions of Section 101. That section provides for the segregation, in certain circumstances, of capital gains and capital losses from other income and the application of a separate rate to each of the two categories of income. Section 101 (a), the substance of which was contained in all the Revenue Acts from 1921 through

[2] If there were any doubt that Section 23 referred to capital losses, it would be removed by Section 101 (c) (4) of the Act, which provides that for the capital net loss determination the term "ordinary deductions" means "the deductions allowed by section 23 other than capital losses and capital deductions." There would be no necessity for the addition of the words "other than capital losses and capital deductions" if those items were not included in Section 23.

1932,[3] provides that where a taxpayer has a capital net gain, there shall, at his election, be levied, collected, and paid—

> * * * in lieu of all other taxes imposed by this title, a tax determined as follows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

This was the provision under which the taxpayer in the *Bliss* case was taxed. The term "ordinary net income" as used in Section 101 is defined (101 (c) (7)) as "the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions." This Court held in the *Bliss* case that to disregard capital gains and capital losses in determining "net income" under Section 23 would be to substitute for net income the different concept "ordinary net income"; that the latter concept was introduced simply as part of a plan for segregating items of net income for purposes of applying separate rates; and that the definition of net income in Section 21 was in no wise affected by Section 101 (a).

Precisely the same analysis is applicable to Section 101 (b), the provision under which the respondent in the case at bar has been taxed. This subsection, the substance of which was contained in all the Revenue

[3] Act of 1921, Sec. 206; Acts of 1924 and 1926, Sec. 208; Act of 1928, Sec. 101.

Acts from 1924 through 1932,[4] provides that where a taxpayer sustains a capital net loss, there shall be levied, collected, and paid—

> * * * in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

It will be observed that this subsection is mandatory where it will produce a greater tax,[5] while Section 101 (a) is permissive; but no distinction pertinent to the question here presented can turn on that difference. Section 101 (b), like 101 (a), provides for the segregation of ordinary net income on the one hand and capital gains and losses on the other, together with the application of a special rate, 12½ per cent, to the latter category. In the case of a taxpayer having a capital net gain (101 (a)), the

[4] Acts of 1924 and 1926, Sec. 208; Act of 1928, Sec. 101.

[5] Whether it will produce a greater tax depends, of course, on a comparison between the special rate and the normal and surtax rates applicable to the taxpayer's income. In Regulations 77, Article 503, an example is given of a case where the special rate would yield a smaller tax; the example is that of a taxpayer having an ordinary net income of $20,000 and a capital net loss of $13,000. See also Section 12 (c) of the 1932 Act, *infra*, p. 26.

special rate is applied to that gain and the product is added to the tax computed on ordinary net income. In the case of a taxpayer having a capital net loss (101 (b)), the special rate is applied to that loss and the product subtracted from the tax computed on ordinary net income. Thus in each case the item of capital gain and capital loss enters into the computation of the tax after being segregated from the other items of net income, which are denominated "ordinary net income." In neither case is there any basis for identifying "net income" with "ordinary net income." Yet the argument of respondent requires exactly such an identification.

The Court of Claims frankly and explicitly identified net income with ordinary net income, stating (R. 20):

> * * * in the case of a taxpayer having a capital net loss his *net income* as defined by section 23 (n) for the purpose of computing the allowable deduction for charitable contributions is "ordinary net income," which is the base for the calculation of the tax.

It was precisely this view that was rejected by this Court in the *Bliss* case, where it was said (293 U. S. at 146–147):

> For "net income," the base specified in § 23 (n) upon which the 15 per cent. deduction of charitable contributions is to be calculated, the petitioner would substitute "ordinary net income" as defined in § 101. So to read the Act would violate its plain terms and run counter to the history of the legislation.

Respondent argued in the court below that his definition of net income as excluding a capital net loss finds support in Section 21, which defines net income as gross income minus the deductions "allowed by section 23." Respondent contends that a capital net loss is not a deduction "allowed" by Section 23 where the tax is computed under Section 101 (b). This argument is untenable for a number of reasons. In the first place, what is allowed as a deduction by Section 23 is not in any event a capital net loss, but capital losses, just as capital gains are included in gross income under Section 22. If capital losses are not "allowed" under Section 23, it would necessarily follow that capital gains are not includible in Section 21; but no basis for such an exclusion has been, or could be, suggested, save the now exploded contention that net income means ordinary net income. In the second place, losses are "allowed" by Section 23 not for the purpose of computing the tax, but for the purpose of defining net income. The language of Section 23 itself is "In computing net income there shall be allowed as deductions:". The term "allowed" refers to the character of the losses and other items as permissible deductions in computing net income; for example, not every loss may be deducted or allowed, but only those incurred in trade or business or in transactions entered into for profit, and not compensated for by insurance or otherwise. In this sense the capital loss of respondent was unquestionably allowed by Section 23. Indeed, if respondent were correct in

insisting that his capital loss cannot be thus "allowed", the capital loss could not be utilized at all, for it can enter into the computation of a capital net loss only if it is a "deductible loss" (101 (c) (2)); and, similarly, capital deductions, which enter into the computation of a capital net loss in the same way as do capital losses, are specifically limited to "such deductions as are allowed by section 23 for the purpose of computing net income" (101 (c) (3)). It is thus plain that capital losses and capital deductions are "allowed" by section 23 where, as here, they enter into the computation of a tax at the special rates provided under Section 101 (b), no less than where the tax is computed without regard to Section 101 (b). In short, the allowance of a capital loss as a deduction under Section 23, so far from being inconsistent with the special treatment of a capital net loss under Section 101 (b), is in fact a necessary condition of such special treatment. In the third place, even if the deductions "allowed" by Section 23 were synonymous with deductions entering into the computation of the tax, the capital loss involved was allowed in that sense also. The effect of the segregation required by Section 101 (b) is simply to tax capital gains at a special rate and deduct capital losses therefrom at the same rate, and to deduct the remainder from ordinary net income taxed at the ordinary rates. The capital loss, or capital net loss, is deducted from gross income in computing the tax, though a rate has been applied

to it different from the rate applied to ordinary deductions.[6] In explaining the provision originally introduced in the 1924 Act which corresponds to Section 101 (b), the Chairman of the Ways and Means Committee of the House made it clear that capital losses were to be allowed as deductions, only the rate being modified; the effect of the provision, he explained, was (65 Cong. Rec., p. 2428)—

> that capital gains and capital losses shall both be placed on the same basis; that capital gains shall be taxed at 12½ per cent, at the election of the taxpayer, and that *capital losses shall*

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[6] A simple formula will demonstrate the point. Let R=rate of tax; o=ordinary income (i. e., gross income exclusive of capital gains); c=capital gains; o^1=ordinary deductions; c^1=capital losses and capital deductions. Then the tax computed without regard to section 101 is $R(o+c-[o^1+c^1])$, or $Ro+Rc-Ro^1-Rc^1$, or $R(o-o^1)+R(c-c^1)$. Section 101 merely substitutes for R a different rate to be applied to c and c^1. This rate may be designated r. Then the tax computed under section 101 is $R(o-o^1)+r(c-c^1)$, or $Ro+rc-Ro^1-rc^1$. It is evident that in the computation of the tax capital gains are included and capital losses deducted, whether or not the tax is computed under section 101, and that the only difference arising from the application of section 101 is in the rate applied to the capital items.

only receive an allowance for deduction at the rate of 12½ per cent.[7] [Italics supplied.]

Respondent contends also, in seeking statutory support for his position, that net income means taxable net income, that respondent's taxable income is his ordinary net income, and that, therefore, his net income is the same as his ordinary net income. Each of the premises of this syllogism is faulty. In the first place, the statute does not use the term "taxable net income." If it did, it would have been necessary to define the term.[8] Instead, the statute

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[7] *Piper* v. *Willcuts*, 64 F. (2d) 813 (C. C. A. 8th), and *Hoffman* v. *Commissioner*, 71 F. (2d) 929 (C. C. A. 2d), cited in respondent's brief in response to the petition for certiorari (p. 1), do not advance respondent's argument, nor do they support the proposition for which they were cited, that a capital net loss "is not a permissible deduction from gross income in computing * * * taxable net income." Those cases hold simply that where there is a capital loss and no capital gain, there is a capital net loss, and accordingly the capital loss is subject to the limitation on rate of deduction in Section 101 (b).

[8] It is true that the Act of October 3, 1917, did use the term "taxable net income" as the base for measuring the maximum deduction for charitable contributions (see R. 21–22). At that time capital gains and losses were not treated separately, and hence there was probably neither significance nor confusion in the use of the term. But beginning with the 1918 Act, and continuously thereafter through the 1932 Act, the term employed has been "net income", appropriately defined. No explanation for the change made in the 1918 Act appears to have been given; the term "taxable" may have been regarded as surplusage at that time, or it may have been thought productive of confusion, as it would have been after the Acts of 1921 and 1924, which began the separate treatment of capital gains and losses.

employs, with explicit definition, the term "net income," which we have already analyzed. In the second place, if the concept of taxable net income is to be imported, it cannot be given the meaning of ordinary net income. To give it that meaning would ignore the fact that, as has been explained, not only ordinary net income but capital gains and losses as well enter into the computation of the tax where there is a capital net gain or a capital net loss. Respondent's argument that his taxable income and his ordinary net income are the same is apparently based on the notion that his ordinary net income is taxed at the rates prescribed in Sections 11 and 12, and the rates in those sections are stated to be applicable to net income. The fallacy in this argument is the assumption that respondent is taxed at all under Sections 11 and 12. In fact, respondent is taxed under Section 101 (b), which levies a tax "in lieu of all other taxes imposed by this title." Section 12 (c) itself recognizes that Section 101, where applicable, imposes a tax "in lieu of normal and surtax." Section 101 (b) occupies the same position in the structure of the Act as Sections 11 and 12, being entitled "Rates of Tax," and where applicable it wholly supersedes the earlier sections. Section 101 (b) simply applies to ordinary net income the rates prescribed in Sections 11 and 12 for net income. It incorporates those rates, as it were, by reference. But only the rates are the same; the subject of the

tax at those rates is net income under Sections 11 and 12 and ordinary net income (prior to the deduction of a capital net loss) under Section 101 (b). There is no more basis for confusing the two here than there was in the *Bliss* case.

What has been said, it is submitted, indicates that under the terms of the Act ordinary net income is not to be confused with net income, that hence a capital net loss must be taken into account in determining net income under Section 23 (n), and that in principle the *Bliss* case, which involved a capital net gain, is indistinguishable from the case at bar. The pertinence of the *Bliss* case to the question of a capital net loss does not rest, however, merely on implication from the decision. The opinion in that case appears to recognize its relevance to the present question. The Circuit Court of Appeals in the *Bliss* case had expressly adverted to this question and had declared that since a capital net loss would be taken into account equally with a capital net gain any advantage to the taxpayer in the situation then before the court would be counterbalanced by the advantage to the Government in the situation which is now presented. The Court of Appeals said (68 F. (2d) at 892):

> It is to be noted that the phrase "ordinary net income" occurs in both paragraph (a), which deals with the case of capital net gain, and paragraph (b), which deals with the case of capital net loss. It must have the same meaning in each. A construction favorable to the taxpayer in the former will operate to

> his detriment in the latter, and vice versa. Hence the canon of strict construction invoked by the commissioner on the theory that the taxpayer is claiming the benefit of an exemption seems inapplicable. We can hardly say that there is any plain advantage to be gained by taxpayers from one construction rather than the other; it depends on whether in the long run cases of capital net gain involve larger sums than cases of capital net loss.

In affirming the decision this Court did not take issue with the reasoning of the Court of Appeals. On the contrary, the opinion of this Court likewise treated the two situations as correlative. The opinion (293 U. S. at 146, note) cited the decision of the Board of Tax Appeals in *Straus* v. *Commissioner*, 27 B. T. A. 1116, in accord with the *Bliss* decision, as a reversal not only of the Board's earlier decisions with respect to capital net gains, but also of the Board's earlier decisions holding that capital net losses are not to be taken into account in computing net income. (*Elkins* v. *Commissioner*, 24 B. T. A. 572; *Livingood* v. *Commissioner*, 25 B. T. A. 585). Furthermore the opinion of this Court refers to the consistent administrative practice from 1923 to 1932 in harmony with the conclusion reached in the *Bliss* case, citing, *inter alia*, I. T. 2104, III–2 Cum. Bull., p. 152. This ruling, announced in 1924, dealt with capital losses, without differentiation between a capital net loss and a capital net gain.

As has been pointed out above (p. 8), four Circuit Courts of Appeals and the Board of Tax Appeals are of opinion that the treatment of capital net gains in accord with the decision in the *Bliss* case requires a treatment of capital net losses in accord with the practice followed by the Commissioner in the present case.

II

THERE ARE NO CONSIDERATIONS OF POLICY WHICH WOULD JUSTIFY A DISREGARD OF THE TERMS OF THE ACT

Respondent contends that the Commissioner has failed to give effect to the Congressional policy of encouraging charitable contributions. It must be remembered, however, that charitable deductions are a matter of grace and can only be allowed where the terms of the Act are plainly met. Even under the estate tax, where, unlike the income tax, charitable contributions are deductible in full, the deduction may be taken only if plainly permitted by the statute. *Taft* v. *Commissioner*, 304 U. S. 351; cf. *Crooks* v. *Harrelson*, 282 U. S. 55, 60; *Helvering* v. *Inter-Mountain Ins. Co.*, 294 U. S. 686, 689-690.

Furthermore, the position of the Commissioner does not ignore the legislative policy of encouraging charitable contributions. As has been observed, although the Commissioner's position is relatively unfavorable to the taxpayer in the present situation, it is the logical corollary of the decision in the *Bliss* case, where the result was to the advantage of

the taxpayer. It may also be pointed out that the Commissioner's treatment of a capital net loss is favorable to the taxpayer under Section 120, which provides that where charitable contributions exceed 90 per cent of net income and have done so for the preceding 10 years, the entire amount of the contributions in the taxable year may be deducted. Since net income is diminished by taking account of a capital net loss, it becomes easier for a taxpayer to take advantage of Section 120 by showing that his charitable contributions have exceeded 90 per cent of his net income.

Finally, the policy of encouraging charitable contributions cannot be viewed in isolation. Another definite and countervailing policy of Congress must be considered: the discouragement of the taking of capital losses to offset ordinary net income. The opportunity to minimize taxes by such a practice constituted a particularly serious problem after the Act of 1921, which reduced the rate of tax on capital net gains. The 1924 Act subjected capital net losses to a correspondingly limited rate in order to protect the revenues. See *Piper* v. *Willcuts*, 64 F. (2d) 813, 815–816 (C. C. A. 8th); 65 Cong. Rec. 2428; H. Rep. 179, 68th Cong., 1st sess., p. 20. The result is that although a taxpayer, like respondent, has no actual income in the economic sense, he nevertheless must pay a tax. This result has been characterized as a "glaring inconsistency" that must nonetheless be given effect (Mr. Justice Roberts, dissenting, in

Helvering v. *New York Trust Co.*, 292 U. S. 455, 472).[9] In comparison with this basic result of the capital net loss provisions, any hardship or apparent incongruity flowing from the denial of a deduction for charitable contributions is relatively insignificant.

In the face of the quite drastic policy regarding capital net losses the courts cannot be asked, it is submitted, to depart from the text of the Act and give controlling force to a policy of encouraging charitable contributions. The problem of harmonizing these policies was one peculiarly for Congress. As will be shown, Congress took no steps to change the administrative practice, which from 1924 to the present time, save for a period of approximately two years, has been consistently in accord with the result for which we here contend.

III

ADMINISTRATIVE PRACTICE OF LONG STANDING SUPPORTS THE POSITION OF THE GOVERNMENT

Shortly after the 1924 Act went into effect, the Commissioner ruled, as we are here maintaining, that capital losses must be taken into account in determining net income for the purpose of measuring the limitation on charitable deductions. I. T. 2104, III-2 Cum. Bull. 152. This ruling has governed the administrative practice under the Acts of 1924, 1926, 1928, and 1932 to the present time, save for a period

[9] While the characterization was made in a dissenting opinion, it was illustrative only and was not the subject of any difference of opinion.

from 1932 to 1934, when the question was thrown into confusion by decisions of the Board of Tax Appeals and was finally resolved by this Court in the *Bliss* case in favor of the earlier consistent practice. The circumstances of this short-lived departure from I. T. 2104 merit explanation.

In November 1931, the Board of Tax Appeals decided, in the *Elkins* and *Livingood* cases, 24 B. T. A. 572, 25 *id.* 585, that I. T. 2104 was erroneous with respect to the 1924 Act, and that capital net losses should not be taken into account in determining net income—exactly the position of respondent in the case at bar. In January 1932, the Bureau announced that the *Elkins* decision would be appealed and that I. T. 2104 would not be revoked or modified, but that until the question should finally be settled it would be necessary to protect the revenues by tentatively adopting a rule in relation to capital net gains comparable to the rule of the *Elkins* case in relation to capital net losses. The Commissioner stated (Mim. 3931, XI–1 Cum. Bull. 33)—

> The Board's decision is contrary to the position which the Bureau has consistently followed as announced in I. T. 2104 (C. B. III–2, 152). The decision will be appealed, and in the audit of returns involving capital net losses, the Bureau will continue to follow I. T. 2104.
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> In view, however, of the decision of the Board in the *Elkins* case, and pending the final decision of the courts on the question, it will also be necessary, in order to protect

fully the interests of the Government, in cases where a taxpayer has a "capital net gain," to compute the 15 per cent limitation on the deduction for contributions upon the basis of the net income excluding the "capital net gain."

A few months later, in August 1932, the Board of Tax Appeals decided *Harbison* v. *Commissioner*, 26 B. T. A. 896, involving a capital net gain, and applied the rule of the *Elkins* case to that situation, producing a result favorable to the Government. It was then that the bureau decided to accept the decisions of the Board in both classes of cases. The non-acquiescences in the *Elkins* and *Livingood* cases were revoked, and acquiescenses were announced. XI-2 Cum. Bull. 3, 6; Mim. 3986, XI-2 Cum. Bull. 29. I. T. 2104 was modified accordingly to make it inapplicable to the 1924 Act. See I. T. 2668, XI-2 Cum. Bull. 268. Following this change of position by the Bureau, the Board of Tax Appeals overruled its decisions dealing with capital net gains (*Straus* v. *Commissioner*, 27 B. T. A. 1116), leaving unsettled the question whether the rulings with respect to capital net losses were also overruled.

It was while the problem was in this state of extreme confusion that the Government sought to sustain the Board's overruled decision in the *Harbison* case, which corresponded to the ruling in the *Elkins* case and which involved a departure from I. T. 2104 and the practice from 1924 to 1932. The departure from I. T. 2104 lasted only until the deci-

sion of this Court in *Helvering* v. *Bliss* (together with *Helvering* v. *Harbison*), 293 U. S. 144.

After that decision the Bureau returned to its former settled practice with respect to both capital net gains and capital net losses, reinstating I. T. 2104. See G. C. M. 14030, XIII–2 Cum. Bull. 135; *id.*, 25, 29. In the case at bar the Government seeks to apply I. T. 2104, which was cited in the *Bliss* case, 293 U. S. at 151, as reflecting the correct administrative practice, approved by several reenactments of the statutory provisions in question.

Respondent seeks to have the Commissioner return full circle to the rule of the Board in the *Elkins* case, which gave rise to the period of confusion and which, we submit, was finally disapproved by this Court in the *Bliss* case.

CONCLUSION

For the reasons stated the decision of the court below is erroneous and should be reversed.

Respectfully submitted.

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OCTOBER 1938.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax equal to the sum of the following: * * *.

SEC. 12. SURTAX ON INDIVIDUALS.

(a) RATES OF SURTAX.—There shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows: * * *.

* * * * *

(c) CAPITAL NET GAINS AND LOSSES.—For rate and computation of tax in lieu of normal and surtax in case of net incomes of not less than $16,000, approximately, or in case of net incomes, excluding items of capital gain, capital loss, and capital deductions, of not less than $16,000, approximately, see section 101.

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.
In computing net income there shall be allowed as deductions:

*   *   *   *   *

(e) LOSSES BY INDIVIDUALS.—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

*   *   *   *   *

(n) CHARITABLE AND OTHER CONTRIBUTIONS.—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * * to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

*   *   *   *   *

(r) LIMITATION ON STOCK LOSSES.—(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined

in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derive. by a taxpayer from the retirement of his own obligations).

*   *   *   *   *

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) TAX IN CASE OF CAPITAL NET GAIN.—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) TAX IN CASE OF CAPITAL NET LOSS.—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) DEFINITIONS.—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * *

SEC. 120. UNLIMITED DEDUCTION FOR CHARITABLE AND OTHER CONTRIBUTIONS.

In the case of an individual if in the taxable year and in each of the ten preceding taxable

years the amount of the contributions or gifts described in section 23 (n) plus the amount of income, war profits, or excess-profits taxes paid during such year in respect of preceding taxable years, exceeds 90 per centum of the taxpayer's net income for each such year, as computed without the benefit of section 23 (n), then the 15 per centum limit imposed by such section shall not be applicable.

U. S. GOVERNMENT PRINTING OFFICE: 1939